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SUBJECT: TREASURY DEPUTY SECRETARY KIMMITT BILATERAL DISCUSSIONS AT
THE IRAQ COMPACT PREPARATORY GROUP MEETING

¶1. (SBU) Summary: Treasury Deputy Secretary Robert M. Kimmitt held a series of meetings on the margins of the October 31 International Compact with Iraq (ICI) Preparatory Group (PG) meeting in Kuwait between October 30 and November 1. The meetings focused on preparation for the PG and key follow-up actions leading to the Compact Ministerial. Notable discussions included the EU/EC, the GOI and a small dinner the evening before the PG.

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October 30: Pre-PG Dinner
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¶2. (SBU) At a small dinner meeting hosted by D/S Kimmitt the evening before the PG meeting, DPM Salih said the Compact would not be a "Madrid II," although Iraq does have large needs, citing the figure of \$100 billion over the next five years. Salih said the Compact would help Iraq meet these needs in a variety of ways, including resolving Iraq's outstanding debt and implementing tough reforms which will help attract investment. Salih repeatedly stressed the importance of technical assistance to improve Iraq's ability to use its existing resources, promising that budget execution in 2007 will be better. As part of this effort, Salih was enthusiastic about establishing a supreme reconstruction board, which will undertake important projects under the current budget. Azez Hassan, the adviser to Finance Minister Jabr, explained that Iraq will need to work through the technicalities of what can, and cannot, be included on the budget with the IMF. Salih also explained that the Compact will improve relations with Iraq's neighbors, which in turn will help improve the security of Iraq's borders.

¶3. (SBU) In the same meeting, D/S Kimmitt made a strong plea for Iraq to address its increasingly serious inflation problem. While Salih made positive noises about the need to act quickly, he also noted that the Central Bank Governor is independent.

¶4. (SBU) Also at this dinner meeting, Special Advisor to the Ministry of Finance Azez Hassan indicated that he expects the MOF to allocate \$8 billion for internal security.

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October 30: EU/EC Bilateral
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¶5. (SBU) D/S Kimmitt also met with EC Middle East and Southern Mediterranean Director for DG RELEX, Christian Leffler, EU Ambassador to Baghdad Ilkka Uusitalo and Finish EU Director General for Africa and the Middle East, Aapo Polho in a bilateral discussion in advance of the ICI PG meeting. Participants exchanged views on status of the Compact document and discuss planned financial support. The EC and EU noted the improved process for the Compact since the September 10 Abu Dhabi PG meeting, highlighting increased inclusiveness and participation. Leffler said the document is solid overall with a few minor edits needed. The EC sought USG views on

the way forward after the Kuwait meeting toward a signing at the end of November.

¶6. (SBU) D/S Kimmitt noted that next steps after the PG meeting will include broadening the Compact supporters beyond the Preparatory Group. To begin this process, Mark Malloch Brown had agreed to host a Compact briefing in New York on or about November 10. Attendees are expected to be Permanent Representatives though capitals are welcome to send attendees. In addition, the UN and GOI would begin a "road show" to key capitals -- particularly in the Gulf -- to develop support for the Compact. The goal for the Ministerial meeting remains in late November or early December.

¶7. (SBU) D/S Kimmitt inquired about planned 2007 EC assistance to Iraq, citing his October 16 conversation in Brussels with Commissioner Benita Ferrero-Waldner in which the Commissioner said EC assistance would drop substantially next year. Leffler confirmed the EC's planned phasing down of assistance over the next five years. Noting the GOI has planned for less donor assistance in its own budget over the next four years in the funding table currently in the Compact draft, and that the EC had heavily front-loaded its assistance, Leffler asserted that the EC's ramp-down in assistance was not a sign of dampening EC support for Iraq. D/S Kimmitt noted that the EU had achieved many of its goals for Iraqi commitments in the text of the Compact document and now needed to step forward to fulfill its side of the agreement. There is a clear need for additional financing, as evidenced by the budget gap in Iraq's budget; while currently fully financed, the GOI is reliant on past year carryovers, donor grant financing and off-budget support for security to fill this financing gap. While all donors will be ramping down over the coming years, D/S Kimmitt opined that the timing and severity of the EC 2007 reduction are particularly troublesome since this will be the first funding decision the EC will make for the Maliki government.

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October 30: GOI Minister Baban
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¶8. (SBU) D/S Kimmitt also met with Iraqi Minister for Planning and Development Cooperation (MOPDC) Baban. During the session Baban made clear that his ministry expects to play a central role in planning and executing the capital investments contemplated under future budgets of the Government of Iraq and in coordinating GOI spending with donor contributions under the Compact. He sees capital spending - particularly in the productive sectors - as key to addressing a broad swath of Iraq's economic problems. He recommends spending the bulk of DFI funds. Baban believes the new hydrocarbon law will be passed very soon. Along with expected gains in Iraqi oil revenues he looks to international donors to provide the additional resources needed in order for MOPDC to maintain its aggressive capital spending plans over the medium term. While not disputing needs for increased capital spending, D/S Kimmitt pressed for clarification on how Iraq plans to address its all too evident impediments to effective budget execution, impressed upon Baban that Iraq must use all the tools available to it to fight inflation (monetary, fiscal and financial) while counseling against depleting the foreign exchange reserves, and explained that Iraq had much work to do demonstrate that it can effectively use the funds available under its budgets and from prior donor pledges (e.g., Madrid) before expecting to receive new donor pledges.

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November 1: GOI FOLLOW-UP MEETING
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¶9. (SBU) To follow-up on key actions leading to the Compact Ministerial (to be scheduled for late November or early December), D/S Kimmitt met with GOI DPM Salih, Central Bank Governor Shabibi and Planning Minister Baban. D/S Kimmitt stressed the need for Iraqi authorship of the Compact "Resolution" (NOTE: this is Section 2 of the ICI document) and to keep the text action-oriented and sharply focused. Kimmitt urged Salih to be in touch with UNDSYG Mark Malloch Brown to host the meeting in New York to broaden Compact

participation on November 10. Kimmitt also stressed the need for the GOI to address budget execution and inflation issues.

¶10. (SBU) DPM Salih agreed to contact Malloch Brown and suggested that Minister Baban lead the GOI delegation to New York. Shabibi noted GOI had raised Kuwaiti debt with the Emir, who had responded that no one was asking them to pay the debt at this time. Shabibi had noted that agreeing to ignore the debt does not help with international investors who will be looking at Iraq's balance sheet when considering investments. Kimmitt proposed discussing this with Kuwait's Central Bank Governor, who had made these same points during an earlier meeting with Kimmitt (septel) which Shabibi agreed to do. Participants noted various conversations with Kuwaiti officials indicating domestic politics in Kuwait are not now conducive to a debt deal, and that securing an international and GCC consensus to relieve Iraq's debt through the Compact would help the Kuwaitis move forward.

¶11. (SBU) On inflation, Shabibi conveyed that he is hopeful the September drop in inflation will hold and that he is waiting for October figures. Kimmitt opined that the GOI needs to be seen moving definitively through monetary, fiscal and banking reform measures. He also stressed that measures like ensuring GOI contracts are paid in dinars, and the USG using dinars in its contracting to the maximum extent possible would help send the signal that the dinar is a strong currency.

¶12. (SBU) Finally, Kimmitt noted that Ali Al-Dabbagh's public statement that Iraq needs \$100 billion over the next five years was not helpful in convincing donors that Iraq is serious about reform. Kimmitt urged DPM Salih to be careful in public comment on Iraqi needs and to ensure that whatever needs exist are clearly articulated via a credible process. DPM Salih agreed this was the best course of action and said he was unhappy with Al-Dabbagh's statement.